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# GERMANY:
# Q1 GDP DROP ONLY THE TIP OF THE ICEBERG

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KATHARINA UTERMÖHL, CFA
Senior Economist Europe
katharina.utermoehl@allianz.com

## Dramatic Q1 GDP decline only the tip of the iceberg

The Covid-19 crisis has pulled the rug out from under the feet of the German economy. According to the Federal Statistical Office's flash estimate, the GDP setback in Q1 2020 amounts to a hefty -2.2% Q/Q - the sharpest rate of decline since the height of the great financial crisis (Q1 2009). As a result the cumulative GDP growth of the last 2.5 years was wiped out - German economic output has fallen back to levels last seen in mid-2017 - even though the Covid-19 restrictions only took full effect in the last two weeks of March. However, if the Q1 data makes you nervous, don't ask about what is in store for the running quarter. After all, confinement measures in April are estimated to have put around 30% of the German economy on ice. The GDP decline in the second quarter is therefore likely to be in double digits. As a result we estimate the German economy to bottom out almost 20% below the level of GDP reached in the final quarter of 2019.

## Sluggish u-shaped economic recovery in H2

In May, in line with the gradual easing of containment measures, the German economy will start to defreeze. In the short term, some catch-up effects can be expected, but the economy's underlying growth momentum is likely to pick up only gradually in the coming months. First of all, some restrictions will continue to apply, such as the ban on major events. In addition, consumers are likely to consume with increased caution even without many restrictions in place. This reluctance to consume will affect in particular services that require direct customer contact, due to ongoing contagion concerns. In addition, the high level of economic uncertainty and widespread job fears - after all, unemployment has risen rapidly and short-time work has been announced for almost a quarter of German workers - are likely to see consumers refrain from making major purchases for the time being.

## Continued interruption of supply chains could weigh on restart

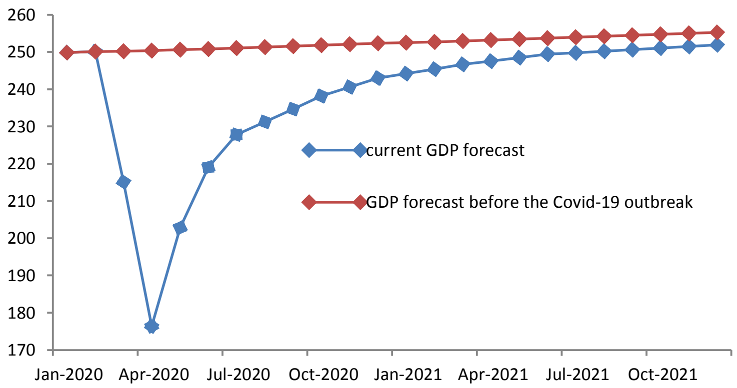
In addition to the sluggish recovery in German domestic demand, the asynchronous economic recovery at a global level and the resulting subdued recovery in global trade is also likely to weigh on prospects for German exports in the coming quarters. In this context, Germany's dependence on international supply chains could turn out to be an additional challenge. After all, close to 20% of German value-added is generated via international supply chains, with the European Union being the most important partner region. The uneven economic recovery in

Europe, could hence delay the supply chain reactivation of an "early opener" like Germany in the most exposed sectors. This in turn will hold back German production despite an emerging recovery in demand. The return to a certain economic normalcy - in which the German economy is once again firing strongly from all cylinders - requires the development of a vaccine and its widespread distribution, which is rather unlikely before mid-2021.

**Germany emerges from the crisis in a stronger position compared to its European neighbors**

The Covid-19 crisis has hit all of Europe with full force, but the German economy looks set to emerge from it swifter and in an stronger position than most of its neighbors. While we expect Germany to suffer a GDP setback of -8.9% in 2020, the recession is likely to be much sharper in several southern European countries in particular Spain (-11%) and Italy (-11.4%). The main reason for this is that other EU heavyweights have been more affected by the virus, which has necessitated a stricter and longer lockdown. Moreover, given the greater importance of the services sector - and tourism in particular - for these economies, a return to pre-crisis GDP is likely to take longer, as these sectors look set to see a delayed and less dynamic restart. Last but not least, however, the decisive and comprehensive policy action on behalf of the German government has been key in limiting the economic damage. The German rescue package including higher government spending and public guarantees after all adds up to more than 30% of economic output, and hence notably exceeds relief measures announced for instance in Spain (12%). This explains in part why insolvencies in Germany are likely to rise by only 10%, while the growth rate for the eurozone as a whole is likely to be twice as high at 20%.

Chart 1 – Germany: Real GDP (in EUR bn, monthly data)




*Sources: Refinitiv, Allianz Research*

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